BLANK

PAGE

FILE COPY

RECEIVED
FEB 28 1964
CLEARINGHOUSE

BLANK

PAGE

INDEX

	Page
Opinion below	1
Jurisdiction	1
Question presented	2
Statutes and regulations involved	2
Statement	2
Summary of argument	7
Argument:	
I. The petitioner elected to report its income on the deferred payment basis in accordance with the method of accounting used in its books and therefore cannot change to the installment basis	8
II. The petitioner cannot now have the income involved taxed as the income of a trust	36
Conclusion	41
Appendix	42

CITATIONS

Cases:	
Ambridge v. *Heiner*, 17 Am. F. T. R. 1022 (W. D. Pa.), not officially reported	24
Anderson v. *United States*, 48 F. (2d) 201	26
Biscayne Bay Islands Co. v. *Commissioner*, 23 B. T. A. 731	27
Boynton v. *Commissioner*, 11 B. T. A. 1352	40
Briarly v. *Commissioner*, 29 B. T. A. 256	24
Burnet v. *Logan*, 283 U. S. 404	10
Burnet v. *S. & L. Bldg. Corp.*, 288 U. S. 406	14, 15
Buttolph v. *Commissioner*, 29 F. (2d) 695	26
Chicago Railway Equipment Co. v. *Commissioner*, 39 F. (2d) 378	21
Cleveland Trust Co. v. *Commissioner*, 24 B. T. A. 132	40
Cohan v. *Commissioner*, 39 F. (2d) 540	21
Commissioner v. *Moore*, 48 F. (2d) 526	24
Continental Bank & Trust Co. v. *United States*, 19 F. Supp. 15	33
Derbes v. *Commissioner*, 24 B. T. A. 276, affirmed 69 F. (2d) 788	24
Dr. Pepper Bottling Co. v. *Commissioner*, 69 F. (2d) 768	26
Ellis, James C. v. *Commissioner*, 16 B. T. A. 1225	25
Garber v. *Commissioner*, 50 F. (2d) 588	24

Cases—Continued. Page

Georgia-Florida Land Co. v. *Commissioner*, 16 B. T. A. 1253 27
Ives Dairy, Inc., v. *Commissioner*, 23 B. T. A. 579, affirmed 65 F. (2d) 135 28, 33, 34
Johnson Realty Trust v. *Commissioner*, 21 B. T. A. 1333 24
Kaplan v. *United States*, 18 F. Supp. 965 32, 33
Key Largo Shores Properties, Inc., v. *Commissioner*, 21 B. T. A. 1008 28, 30, 34
LeBolt & Co. v. *United States*, 67 C. Cls. 422 33
Lee, Gilbert W. v. *Commissioner*, 6 B. T. A. 135 24
Livermore v. *Miller, Prentice-Hall*, 1938, Vol. 1, Par. 5.177 24, 31, 32
Lewis & Co. v. *Commissioner*, 301 U. S. 385 40
Lorenzen v. *United States*, 52 F. (2d) 106 39
Lucas v. *St. Louis National Baseball Club*, 42 F. (2d) 984, certiorari denied, 282 U. S. 883 23, 26
McEachern v. *Rose*, No. 6, October 1937 Term, 302 U. S. 56 14
Moran v. *Commissioner*, 67 F (2d) 602 35
Morgan Rundel v. *Commissioner*, 21 B. T. A. 1019 24, 25, 29
Morris v. *Commissioner*, 40 F. (2d) 504 23, 26
Morrow, Becker and Ewing, Inc., v. *Commissioner*, 57 F. (2d) 1 29
Munger v. *Commissioner*, 16 B. T. A. 168 40
Pathe Exchange v. *Commissioner*, 77 F. (2d) 306 33
Pugh v. *Commissioner*, 17 B. T. A. 429 40
Radiant Glass Co. v. *Burnet*, 54 F. (2d) 718 26
Rose v. *Grant*, 39 F. (2d) 340 26
Safety Electric Products Co. v. *Helvering*, 70 F. (2d) 439 26
Strauss, Sylvia S. v. *Commissioner*, 33 B. T. A. 855, affirmed *per curiam*, 87 F. (2d) 1018 24
B. B. Todd, Inc., v. *Commissioner*, 1 B. T. A. 762 14
United States v. *Andrews*, No. 48, October 1937 Term 39
United States v. *Felt & Tarrant Co.*, 283 U. S. 269 38
United States v. *Garbutt Oil Co.*, No. 262, October 1937 Term 39
United States v. *Memphis Cotton Oil Co.*, 288 U. S. 62 38
United States v. *Oregon Lumber Co.*, 260 U. S. 290 36
United States v. *Pettigrew*, 81 F. (2d) 666 25
United States v. *Seminole Nation*, 299 U. S. 417 39
Viault v. *Commissioner*, 36 B. T. A. 430 24
Walker, Mrs. H. C., Jr. v. *Commissioner*, 23 B. T. A. 1, affirmed 63 F. (2d) 346 24, 31, 32
Zellerbach Co. v. *Helvering*, 293 U. S. 172 37

Statutes:

Revenue Act of 1926, c. 27, 44 Stat. 9:
Sec. 212 (d) 42
Sec. 1208 42
Revenue Act of 1928, c. 852, 45 Stat. 791:
Sec. 21 43
Sec. 22 10, 43
Sec. 41 44

Statutes—Continued. Page

Sec. 42 44
Sec. 43 44
Sec. 44 45
Sec. 111 ..... 10, 46
Sec. 112 ..... 10, 47
Sec. 113 ..... 10, 47

Miscellaneous:

G. C. M. 2185, VI–2, Cum. Bul., p. 75 40
G. C. M. 4120, VII–2, Cum. Bul., p. 108 40
T. D. 4265 38
Treasury Regulations 33, Art. 117 14
Treasury Regulations 45:
Arts. 42–46 14
Art. 62 14
Art. 65 14
Treasury Regulations 74:
Art. 321 47
Art. 322 48
Art. 331 48
Art. 352 48
Art. 353 49
Art. 354 50

BLANK

PAGE

In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 528

PACIFIC NATIONAL COMPANY, A CORPORATION
PETITIONER

v.

GALEN H. WELCH, FORMER COLLECTOR OF INTERNAL REVENUE, FOR THE SIXTH DISTRICT OF CALIFORNIA

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINION BELOW

The District Court did not render a written opinion. The opinion of the Circuit Court of Appeals (R. 198–207) is reported at 91 F. (2d) 590.

JURISDICTION

The judgment of the court below was entered on August 2, 1937 (R. 207). The petition for certiorari was filed on October 25, 1937, and was

granted on December 6, 1937. The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The only question presented by the petition for certiorari is whether the petitioner, which in 1929 reported its income for 1928 from the sale of real estate as deferred payment sales not on the installment plan, is bound by that election or can later, in 1931, claim a refund of taxes by having its gain from the sales of realty taxed on the installment basis.

Although not raised in its petition, the petitioner also asks this Court to decide the further question whether the petitioner is taxable upon only its alleged distributable share of the income of the subdivision trust involved.

STATUTES AND REGULATIONS INVOLVED

The pertinent portions of the applicable statutes and treasury regulations are printed in the Appendix, *infra*, pp. 42–51.

STATEMENT

This action was brought by Pacific National Company, the petitioner, in the United States District Court for the Southern District of California to recover from the respondent, a former Collector of Internal Revenue for the Sixth Collection District of California, the sum of $9,669.89, with in-

terest, paid by the petitioner as Federal income taxes due for the year 1928 (R. 4–11). A jury was waived (R. 37–38), and the cause tried to the court upon a stipulation of facts (R. 39–105) and oral and documentary evidence (R. 106–157). The District Court did not render an opinion but made special findings of fact and conclusions of law (R. 23–31) and entered judgment for the respondent (R. 32–33). The petitioner appealed to the Circuit Court of Appeals for the Ninth Circuit (R. 182) assigning numerous errors (R. 183–188). That court rendered an opinion and affirmed the decision of the District Court (R. 198–207).

The facts stipulated and found by the trial court, so far as material here, may be summarized as follows:

The petitioner is a corporation organized under the laws of the State of California, having its principal office and place of business at Los Angeles, California (R. 23, 40).

In 1927 the petitioner purchased the legal title to certain real property, known as the Culver City Tract, for a consideration of $609,000, of which $309,000 was paid in cash and $300,000 was represented by purchase money notes (R. 44, 115). This property was conveyed to the Pacific National Bank, as trustee, under a trust agreement designated as Trust No. P. T. 46 (R. 24, 44, 68–92). The petitioner became sole beneficiary under this so-called "subdivision trust" and remained so during the year 1928 (R. 24, 44, 114).

In October 1927 the petitioner employed one Frank J. Brick as exclusive selling agent to conduct a sales campaign to sell lots from the property transferred under the trust agreement designated No. P. T. 46. With the knowledge, consent, acquiescence, and approval of the petitioner, Brick successfully conducted a high pressure sales campaign (R. 28, 44, 54–61). The petitioner obtained and retained financial benefit from the sales made by Brick (R. 28).

The petitioner prepared its 1928 income tax return from its books of account and upon the same basis upon which those books were kept (R. 24).

The petitioner filed its income tax return (R. 128–139) for the year 1928 on March 14, 1929, disclosing net income of $89,677.34 and a tax due thereon in the sum of $10,761.28, which was paid to the respondent in quarterly installments during 1929 (R. 24–25, 41). The income of $89,677.34 shown on the petitioner's 1928 return was made up as follows (R. 25, 42, 128–130):

Income from Trust No. P. T. 46, Pacific National Bank, Trustee	$137,007.17
Less:	
Loss of Plaintiff from its 1928 operations, exclusive of the trust income	11,480.37
Statutory net losses of plaintiff, as follows:	
1925	1,990.77
1926	9,708.66
1927	24,150.03
	47,329.83
Net income as reported	89,677.34

The sum of $137,017.17 representing the income from Trust No. P. T. 46 resulted from the sale of subdivision lots. In determining that income the sales were treated as deferred payment sales not on the installment plan and the obligations of the purchasers were treated as having a fair market value equivalent to their face value (R. 25, 43).

The Pacific National Bank, as trustee under Trust No. P. T. 46, kept the books and records of the trust upon the basis of cash receipts and disbursements.[1] This trustee did not file a fiduciary or other income tax return for the trust for the years 1927 or 1928, nor did the successor trustee do so prior to the institution of this action (R. 25–26, 43).

On February 26, 1931, the petitioner filed with the Collector of Internal Revenue at Los Angeles, California, a claim for refund of the full amount of income taxes paid for 1928. The only ground for refund stated in that claim which is material to this proceeding was that (R. 26, 41, 46–48):

> (3) Profit from sales of real estate in a subdivision trust were erroneously reported as based on closed sales, although the sales were made on the installment basis and pro-

[1] It was not expressly found or stipulated but it appears that the petitioner kept its books on a cash receipts and disbursements basis in which the purchasers' contracts were treated as the equivalent of cash received in the amount of their face value. The income was reported in accordance with this method of keeping the books (R. 108–114).

ceeds of sales and collections were allocated by the trustee.

On April 4, 1932, the petitioner filed another claim for refund of the full amount of income taxes paid for 1928, stating as grounds for its claim that (R. 28, 41, 50–52):

> Claimant now wishes to amend the claim by showing that the subdivision trust is a separate entity, an association taxable as a corporation, that it did not file a consolidated return with claimant in 1928, and that its 1928 income can not be included in claimant's income or return. Accordingly, the income of the subdivision trust must be excluded from claimant's 1928 income, and the tax paid thereon by claimant, refunded. This situation prevents the doctrine of estoppel from applying to this case.

On May 17, 1932, the Commissioner of Internal Revenue allowed the petitioner's claim for refund filed February 26, 1931, to the extent of $1,091.39, upon grounds not in issue in this proceeding, and rejected it as to the balance. On July 25, 1932, the Commissioner confirmed the rejection of May 17, 1932, and in his ruling of July 25, 1932, he considered all of the claims theretofore filed by the petitioner (R. 27–28, 42).

Petitioner filed no claims for refund of the tax involved in this proceeding other than those filed February 26, 1931, and April 4, 1932 (R. 28).

The issue that Trust No. P. T. 46, Pacific National Bank, Trustee, was an association taxable

as a corporation and not as a trust was not presented to the Commissioner of Internal Revenue in any claim for refund filed prior to April 4, 1932, and this claim for refund was not filed within two years from the date of payment of any portion of the tax reported for the calendar year 1928 (R. 28).

In the stipulation of facts filed with the District Court it was agreed that upon a decision of the legal questions involved the determination of the correct amount of tax under the decision would be referred back to the parties for settlement (R. 44–45). During the progress of the trial it was further stipulated that should the court decide either that the petitioner is entitled to change its method of computing income or that the trust should have reported the income on the basis of an association taxable as a corporation there would be some refund due. It was further agreed that should a change of basis be granted no income would escape taxation in subsequent years by reason of the statute of limitations (R. 118).

SUMMARY OF ARGUMENT

I

The petitioner elected to report its income on the deferred payment method and not on the installment basis. The method adopted is authorized by the Revenue Act of 1928 and the treasury regulations, was used in the petitioner's books and income tax return, and clearly reflected the petitioner's income.

Such an election is binding and prevents the petitioner from changing to the installment basis in a claim for refund in order to have a lesser income and a refund determined. Any general rule permitting such changes would hinder administration of the revenues.

II

The contention, now raised for the first time and not presented in the petition for certiorari, that the income is taxable as the income of a trust, cannot be considered in this action because it was not presented in a timely refund claim and was not presented in this action below. Moreover, the contention is without merit because this trust, a mere security device, is not taxable as a trust.

ARGUMENT

I

THE PETITIONER ELECTED TO REPORT ITS INCOME ON THE DEFERRED PAYMENT BASIS IN ACCORDANCE WITH THE METHOD OF ACCOUNTING USED IN ITS BOOKS AND THEREFORE CANNOT CHANGE TO THE INSTALLMENT BASIS

The petitioner contends in Point I of its brief (pp. 7–26) that the installment basis alone reflects the income from its real estate venture, and that it is entitled to have the refund claim considered on that basis because the method of reporting the income used in its income tax return was erroneous.

The respondent contends that the method of reporting the income from real estate sales adopted

by the petitioner (A) was authorized by law, (B) was used in the petitioner's books and income tax return, (C) clearly reflects income, (D) was a binding election which prevents a change to the installment basis in the refund claim, and (E) cannot be changed to the installment basis without burdening and impeding administration of the revenues.

The fundamental error in the petitioner's contention is the failure to observe and apply the distinction between (a) a situation, as here, where the method of reporting income elected by the taxpayer clearly reflects income but in using this valid method a mistake in valuation of the sales contracts may have been made and (b) a situation not present herein which as a matter of law the method used is inapplicable.

In this case the method of reporting installment sales as deferred payment sales not on the installment plan is capable of clearly reflecting the petitioner's income even though the petitioner may have erroneously computed the *amount* of the fair market value of the sales contracts in using this method. In such a situation any overstatement of income must be corrected in accordance with the method adopted and not by a change of method. The taxpayer here has erroneously sought to change its method, but has not sought to correct an alleged overstatement of income by the usual and only proper procedure of an amended return and a timely refund claim and suit in accordance with its method of reporting income.

A. THE DEFERRED PAYMENT METHOD OF REPORTING INCOME FROM INSTALLMENT SALES IS AUTHORIZED BY THE STATUTE AND REGULATIONS

1. This method is authorized by the statute

Section 22 (a) of the Revenue Act of 1928 which defines gross income expressly provides that gross income includes gains, profits, and income derived from sales of real property. Section 22 (e) provides that the gain or loss on the sale of property shall be computed as provided in Sections 111, 112, and 113.

Section 111 (a) provides that the gain from the sale of property shall be the excess of the "amount realized" over the basis provided in Section 113. Section 111 (c) provides that the amount realized shall be the sum of any money received plus the fair market value of the property (other than money) received.

Articles 354 and 561 of Treasury Regulations 74 under the 1928 Act provide for the exceptional case in which the property or obligations of the vendee received by the vendor have no fair market value. In such a case the cash and any property with a fair market value which is received is applied to reduce the vendor's basis of the property sold and the excess, if any, is taxed. Gain or loss is realized when the obligations are disposed of or satisfied to the extent of the difference between the reduced basis and the amount realized. Cf. *Burnet* v. *Logan,* 283 U. S. 404.

These provisions of the statute and regulations provide a complete and accurate method for determination of gain or loss on the sale of real property. Further provisions for computation of taxable income from such sales were not necessary but Congress provided an alternative method of reporting income on the installment basis in some cases.

Sections 41 to 48, Title I of the 1928 Act, are designated "Part IV—Accounting Periods and Methods of Accounting," and contain the provisions with respect to the installment basis.

Section 41 (Appendix p. 44) provides in part:

> The net income shall be computed * * * in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income.

Section 44 (a) (Appendix p. 45) provides that a dealer in personal property on the installment plan may return as income therefrom in any taxable year

> that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

Section 44 (b) provides that in the case (1) of a casual sale of personal property under stated conditions, or

> (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 40 per centum of the selling price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section.

These provisions of the statute, apart from the treasury regulations, disclose two alternative methods of reporting income from installment sales. Section 111 provides the general method applicable to all sales. Section 44 provides an alternative and special method applicable to some sales.

2. This deferred payment method is authorized by the regulations

Treasury Regulations 74, Articles 352–354, (Appendix pp. 48–50), expressly authorized by Section 44, regulate the use of these two methods of reporting income from installment sales. Article 352 divides deferred payment sales of real property into (1) sales in which payments received during the taxable year in which the sale is made do not exceed 40% of the selling price, called sales on the installment plan, and (2) sales in which the payments do exceed 40% of the selling price, called deferred payment sales not on the installment plan.

Article 353, with respect to sales on the installment plan, provides that the vendor "may" return the income on the installment basis or:

> If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursements basis, such a course is permissible, and the sales will be treated as deferred-payment sales not on the installment plan.

Article 354 provides in part that in deferred payment sales of real property not on the installment plan

> the obligations of the purchaser received by the vendor are to be considered as the equivalent of cash to the amount of their fair market value in ascertaining the profit or loss from the transaction. * * * If the obligations received by the vendor have no fair market value, the payments in cash or other property having a fair market value shall be applied against and reduce the basis of the property sold, and, if in excess of such basis, shall be taxable to the extent of the excess. Gain or loss is realized when the obligations are disposed of or satisfied, the amount being the difference between the reduced basis as provided above and the amount realized therefor. Only in rare and extraordinary cases does property have no fair market value.

3. Congress has approved the Regulations

The Treasury Regulations applying the two different statutory methods of reporting income on the sale of real estate on the installment basis have been approved by Congress (a) by the enactment of the 1926 Act and (b) by reenactment of the provisions of the 1926 Act in all of the later Revenue Acts.

a. Prior to Section 212 (d) of the Revenue Act of 1926, which contained provisions similar to Section 44 of the 1928 Act, the Revenue Acts did not expressly provide a method for computation of net income on the installment basis but the Commissioner's regulations permitted the use of this method.[2] *Burnet* v. *S. & L. Bldg. Corp.*, 288 U. S. 406, 413; cf. *McEachern* v. *Rose*, No. 6, this Term, 302 U. S. 56, 57 (preliminary print). Following the decision in *B. B. Todd, Inc.*, v. *Commissioner*, 1 B. T. A. 762, (decided March 16, 1925) to the effect that the statute (the Revenue Act of 1918 in that case) did not authorize the installment basis used in the regulations, the Revenue Act of 1926, Section 212 (d) adopted "the basic principles of the installment method authorized by prior regulations." *Burnet* v. *S. & L. Bldg. Corp.*, 288 U. S. 406, 413–414.

b. The provisions of the Revenue Acts and Regulations applying one of these two methods of re-

[2] Article 117, Treasury Regulations 33 (Revised Edition promulgated January 2, 1918); Articles 42–46, Regulations 45, 62, 65.

porting income from the sale of real property have been repeatedly reenacted in the later Revenue Acts and Treasury Regulations. This reenactment of the statutory provisions after the deferred method had been applied to the installment sales of real estate is an approval of this method. *Burnet* v. *S. & L. Bldg. Corp.*, 288 U. S. 406, 415.

B. THE DEFERRED PAYMENT METHOD WAS USED BY THE PETITIONER IN ITS BOOKS AND RETURN

The petitioner purchased the realty, known as the Culver City Park Tract, for $309,000 cash and $300,000 of its purchase money notes secured by a declaration of trust dated July 1, 1927 (R. 68–93), which created a so-called subdivision trust (R. 114), a security device (R. 29, 199–200) commonly used in the development and sale of a tract of land divided into residential lots. Cf. Treasury Regulations 74, Article 351. The property was conveyed to the trustee for the purposes of the trust (R. 44). The declaration of trust provided that the entire sales price of every lot and all interest on each contract of sale should be paid to the trustee and that all sums received by the trustee from the sale of lots should be used to pay the expenses and improvements of the property and the purchase money notes and any balance should be paid to the petitioner (R. 82–84).

The form of installment sales contract (R. 94–105) used in selling lots in 1928 (R. 44) provides that the trustee, as seller, agrees to sell and con-

vey the property and the buyer agrees to pay part of the purchase price upon execution of the agreement and the balance in monthly installments with 7 per cent interest (R. 94–95). The buyer agrees to pay to the seller all assessments against the property (R. 96). The contract provides that full performance by the buyer is a condition precedent to his right to a conveyance. Upon any default of any payment of principal or interest the seller may take possession of the premises and all payments made by the buyer and improvements on the land shall be retained by the seller as liquidated damages (R. 96–97).

The record does not disclose which lots or how many lots were sold for cash, or for a down payment of more than 40 per cent of the contract price, or for a down payment of less than 40 per cent which would have permitted use of the installment basis in the original return for such sales.[3]

1. The trustee kept books of the activities of the trust and allocated the cost of the tract and the expenses of improvements of the property to the separate lots. When a lot was sold the profit was determined by deducting from the selling price the cost of the lot, improvements, and commissions. From these data, obtained from the trustee, the petitioner made the entries on its records and books

[3] The record contains only the general statement of F. W. Shelton, secretary of the petitioner from 1926 to 1930, that "Most of the contracts were sold on the basis of 25 percent down and the balance over a period of time" (R. 108).

kept in the regular course of its business and disclosed the cost, expenses, sales price, and profit from the lots sold in 1928 (R. 108–114).

The petitioner's books disclosed a gross profit in 1928 from sales of the real estate in the sum of $306,181.69 and thus treated the sales contracts as equivalent to cash and used the deferred payment method of accounting not on the installment plan (R. 111). The petitioner did not calculate the income on the installment basis on its books.

2. The petitioner's return for 1928 (R. 128–139) disclosed income from the trust in the sum of $137,007.17 computed in accordance with the method of accounting employed in keeping the books of the petitioner by treating the sales as deferred payment sales not on the installment plan and by treating the obligations of the petitioner as having fair market value equivalent to their face value (R. 42–43).

C. THE DEFERRED PAYMENT METHOD CLEARLY REFLECTS THE PETITIONER'S INCOME

The deferred payment method clearly reflects income from installment sales by treating the obligations of the purchaser as cash to the amount of their fair market value in ascertaining profit or loss from the transaction. If they have no fair market value they are not included in computing the gain or loss and gain or loss attributable to them is realized when they are disposed of or satisfied. Regulations 74, Art. 354, Sec. 111 (c) of the 1928 Act.

If the purchaser defaults in any of his payments under either the deferred payment or installment method the profits previously reported as income are considered in computing gain or loss. Regulations 74, Articles 353–354. Similarly, if an installment obligation is satisfied at other than its face value or is sold or exchanged the computation of profit or loss is based on the amount of income which would be returnable if the obligation was satisfied in full and thus is based on the amount of profit or loss previously returned. Revenue Act of 1928, Section 44 (d), Regulations 74, Article 355.

It is plain that as a general matter the deferred payment method does "clearly reflect the income" (Section 41 of the 1928 Act) from installment sales. The respondent submits that this method clearly reflects income in the instant case.

Under the deferred payment method provided by the statute and regulations in force when the petitioner made its return for 1928, the fair market value of the sales contracts in the year of the sales might have been fixed at an amount less than their face value if the facts warranted such a computation. In such a case payments on the contracts in later years in excess of the estimated fair market value might have been returned as income when received. Indeed, as is pointed out *infra*, p. 35, a change *from* the installment *to* the deferred payment method has been permitted in certain cases where the obligations became valueless or

greatly decreased in value in the year of receipt. These cases indicate that in such circumstances the deferred payment method more accurately reflects income.

In using the deferred payment method the petitioner chose to consider the contracts as worth their face value. In such a case, if the buyer defaulted in a later year, or if the contract obligation was satisfied for less than its face value, the computation of the profit or loss in the later year would be based on the income reported in the year of sale (Regulations 74, Article 355).

Moreover, the petitioner never presented to the Commissioner the contention that the contracts did not have a fair market value equal to their face value and that, therefore, income on the deferred payment method should be recomputed and a refund should be allowed. The petitioner's books used face value of the contracts. The original return (R. 128–139) used face value of the contracts in reporting income. No amended return alleging, or setting forth proof of, a fair market value less than face value, was filed. The refund claim (R. 46–49) does not state that the face value was greater than fair market value but merely states that an error was made in reporting on a closed transaction or deferred payment basis instead of on the installment basis (R. 48).

In computing income on the installment basis the face value and not on the fair market value of the

buyer's contract obligations is used. In this action, the petitioner has relied wholly on the legal contention that the installment basis should be used and has not proved a fair market value of the sales contracts less than their face value which it might have attempted to do in an amended return, a timely refund claim, and a timely action on that ground.[4]

Furthermore, the amount of the difference between the face and fair market value of the contracts, if any, does not appear. There is no substantial competent evidence, finding of fact, or proposed finding by the petitioner on this question.

The only facts disclosing the possibility of a difference between face and fair market value of the contracts is the general statement of Elwell that the contracts had a face value of one-third to one-half of the sales price (R. 117–118) and the fact

---

[4] The only evidence in the record on the question of fair market value of the sales contracts is the one general and somewhat ambiguous statement of the petitioner's witness, William H. Elwell, to the effect that the contract had a fair market value of from one-third to one-half of the selling prices, and that their fair market value when executed would be reduced by the cash payments (R. 117–118).

Although the witness testified that he was not interested in the outcome of the case (R. 118), it is apparent that he was interested in the question of value of the contracts because he was the sales agent who stated that he could not sell the lots for the prices obtained, and he had also maintained that they were not worth such prices (R. 115–118). He had at least the motive of supporting his business judgment in stating that fair market value was less than face value of contracts. He gave no detailed reasons for his opinion.

that some of the contracts involved "delinquent accounts" in 1928 (R. 143).[5]

Even though the sales prices might have been excessive in some cases the contracts may have had a fair market value approximately equal to face value. The buyers, unlike buyers of land for speculative purposes which are often financially irresponsible corporations organized for that purpose, were individuals, prospective subdivision homebuilders, and presumably financially responsible. The large cash down payment of 25 per cent. (R. 108) would tend to assure performance of the contracts even though the sales prices were somewhat excessive because the down payment would be lost by non-performance and thus even a new contract for another lot at a more reasonable price might eventually be no less expensive. The sales

[5] The petitioner's exhibits 9 and 10 (R. 143–144) are statements prepared by the petitioner's witness Kaplan from the books of the trustee which purport to set forth some slight information concerning "delinquent accounts." They do not show the extent of delinquency of the accounts. There is nothing to show that delinquent accounts were not later collected in full. These exhibits were admitted in evidence over the respondent's objections and exceptions on the ground that the books of account were the best evidence (R. 119–123). These exhibits, prepared by one who did not keep the books, were inadmissible when the books were not in evidence. *Cohan* v. *Commissioner*, 39 F. (2d) 540, 544 (C. C. A. 2nd). The petitioner's failure to produce or introduce the books in evidence raises the presumption that the evidence was unfavorable to it. *Chicago Railway Equipment Co.* v. *Commissioner*, 39 F. (2d) 378, 380 (C. C. A. 7th).

contract provided that title should not be conveyed until all payments were made and that 7 per cent. interest should be paid on all installments. The seller might repossess the land and keep the payments and improvements made or seek specific performance. Such a typical "seller's contract" for the sale of lots in a residential subdivision for permanent residence might be worth a fair market value equal or nearly equal to its face value even if the sales prices were excessive.

D. THE USE OF THE DEFERRED PAYMENT METHOD IS A BINDING ELECTION WHICH PREVENTED THE PETITIONER FROM CHANGING TO THE INSTALLMENT METHOD IN THE REFUND CLAIM

The petitioner's books and return filed on March 14, 1929, used the deferred payment method. Not until the refund claim (R. 46–49) was filed almost two years later on February 26, 1931, did the petitioner suggest that it wished to use the installment method by the statement in the refund claim that profits were erroneously reported as based on closed sales although the sales were made on the installment basis (R. 48). The respondent submits that a taxpayer cannot wait two years perhaps until offsetting deductions in later years are determined, and then in a refund claim attempt to change its method of accounting for profits and losses in order to report income in a different manner and amount and in different years in order to obtain a smaller tax and a refund.

1. The statute requires an election

The statute contemplates that the taxpayer shall elect one method of accounting. Section 44 (b) states that a taxpayer who makes an installment sale of realty *may* use the installment method. Section 44 (c) states that if a taxpayer *elects* to report income on the installment basis amounts received in the taxable year on sales in prior years shall not be excluded.

Similarly the rule of a binding election by the taxpayer is recognized in other sections of the Revenue Act of 1928. Section 51 provides for single returns or joint returns by a husband and wife living together and the choice made is a binding election. *Morris* v. *Commissioner* 40 F. (2d) 504 (C. C. A. 2d); Sections 52, 141, and 142 provide for separate or consolidated returns of affiliated corporations and the choice made is a binding election. *Lucas* v. *St. Louis National Baseball Club,* 42 F. (2d) 984 (C. C. A. 8th), certiorari denied 282 U. S. 883. Section 56 (b) and (e) provides that a taxpayer "may elect to pay the tax" in four installments or even in advance "at the election of the taxpayer." Section 101 provides for the tax on capital net gain "at the election of the taxpayer." Section 131 (d) provides that a taxpayer has the option or election to take the credit for foreign taxes in the year accrued irrespective of his method of accounting.

It is apparent that the rule of a binding election must be observed in order to avoid the confusion in

the administration of the revenue laws which would result if a taxpayer might change his method of accounting if subsequent events disclose a smaller tax would result. It is submitted that Congress intended that the taxpayer's choice of the deferred payment or installment method of accounting should constitute an election, and, like the other statutory elections under the Act, should be binding.

2. The election is binding

Choice of the deferred payment or installment method has been held to be an election prohibiting a change to the other method. *Livermore* v. *Miller,* decided January 26, 1938, by the Fifth Circuit Court of Appeals, Prentice-Hall Federal Tax Service, 1938, vol. 1, paragraph 5.177; *Commissioner* v. *Moore,* 48 F. (2d) 526, 528 (C. C. A. 10th); *Ambridge* v. *Heiner,* 17 Am. Fed. Tax. Rep. 1022 (W. D. Pa., not officially reported); *Sylvia S. Strauss* v. *Commissioner,* 33 B. T. A. 855, affirmed *per curiam,* 87 F. (2d) 1018 (C. C. A. 2d); *Johnson Realty Trust* v. *Commissioner,* 21 B. T. A. 1333; *Morgan Rundel* v. *Commissioner,* 21 B. T. A. 1019; *Gilbert W. Lee* v. *Commissioner,* 6 B. T. A. 135. Cf. *Garber* v. *Commissioner,* 50 F. (2d) 588 (C. C. A. 9th); *Viault* v. *Commissioner,* 36 B. T. A. 430; *Briarly* v. *Commissioner,* 29 B. T. A. 256; *Derbes* v. *Commissioner,* 24 B. T. A. 276, affirmed 69 F. (2d) 788 (C. C. A. 5th); *Mrs. H. C. Walker, Jr.* v. *Commissioner,* 23 B. T. A. 1, affirmed 63 F.

(2d) 346 (C. C. A. 5th); *James C. Ellis* v. *Commissioner*, 16 B. T. A. 1225.

In *Gilbert W. Lee* v. *Commissioner, supra,* the evidence showed that the taxpayer's returns were upon the installment basis in effect and in refusing to permit a change to the straight cash receipts basis the Board stated at page 138:

> Having once made his election, the petitioner should not be allowed to change to a different basis merely because subsequent legislation or other events made it to his interest so to do.

In *Morgan Rundel* v. *Commissioner, supra,* the Board refused to allow a change from the installment basis and stated the rule at page 1020:

> Subsequent events or a change of mind now make petitioner's choice of the installment basis not to his liking, and so he seeks another method which it is claimed will produce a lower tax.
>
> It has been held, however, in a number of cases that the filing of a return of income according to one of two alternative methods recognized by statute constitutes a binding election and the taxpayer may not thereafter report on another basis. * * *

The rule requiring the taxpayer to elect in the original return the method of reporting income operates also in the closely analogous situations of single or joint returns by husband and wife (*United States* v. *Pettigrew,* 81 F. (2d) 666

(C. C. A. 9th); *Anderson* v. *United States,* 48 F. (2d) 201 (C. C. A. 5th); *Morris* v. *Commissioner,* 40 F. (2d) 504 (C. C. A. 2d); *Rose* v. *Grant,* 39 F. (2d) 340 (C. C. A. 5th); *Buttolph* v. *Commissioner,* 29 F. (2d) 695 (C. C. A. 7th), and of consolidated or separate returns by affiliated corporations *Safety Electric Products Co.* v. *Helvering,* 70 F. (2d) 439 (C. C. A. 9th); *Dr. Pepper Bottling Co.* v. *Commissioner,* 69 F. (2d) 768 (C. C. A. 5th); *Radiant Glass Co.* v. *Burnet,* 54 F. (2d) 718 (App. D. C.); *Lucas* v. *St. Louis National Baseball Club,* 42 F. (2d) 984 (C. C. A. 8th), certiorari denied, 282 U. S. 883. The election once made is binding.

The doctrine of election has been continuously utilized in the revenue acts and enforced by the courts. The authorities cited above disclose that its operation is necessary in the administration of collection and refund of the revenues. Like the statutes of limitations upon assessment and collection, refund claims, and suits to recover taxes, application of the doctrine of election is an equitable means of realizing to some degree the public policy of repose and termination of tax litigation.

3. Congress has approved the rule requiring a binding election

The statutory provisions of the 1926 and 1928 Acts with respect to reporting income from installment sales, interpreted by the cases cited above to require a binding election, have been reenacted in all the later revenue acts. This reenactment is a

legislative approval of the rule of election. In *Burnet* v. *S. & L. Bldg. Corp.*, 288 U. S. 406, 415, the Court stated that the Board of Tax Appeals had consistently upheld the regulations in respect of profits on installment sales and then the Court remarked that the later revenue acts substantially reenacted the pertinent provision of the 1926 Act.

4. The present case should be distinguished from situations in which a method adopted is not applicable to the taxpayer under the terms of the statute or does not clearly reflect income

The present situation of a binding election of one of two applicable methods of reporting income from installment sales, both of which clearly reflect the petitioner's income, must be distinguished from situations (involved in some of the decisions relied on by the petitioner) of an erroneous use of a method of accounting which is not applicable to a taxpayer under the terms of the statute or which does not clearly reflect income.

If the taxpayer, under the 1928 Act, attempts to use the installment basis for sales in which the down payment is more than 40% of the sales price, a binding election may not occur because the statute does not permit taxation of income on such sales on the installment basis. In such a case the error may be corrected and income computed on the deferred payment basis. *Biscayne Bay Islands Co.* v. *Commissioner*, 23 B. T. A. 731, 735; *Georgia-Florida Co.* v. *Commissioner*, 16 B. T. A.

1253, 1259. The instant case is distinguishable because the petitioner is attempting to change from deferred payment method which is applicable to it under the statute.

Cases relied on by petitioners, such as *Key Largo Shores Properties, Inc.*, v. *Commissioner*, 21 B. T. A. 1008, and *Ives Dairy, Inc.*, v. *Commissioner*, 23 B. T. A. 579, affirmed 65 F. (2d) 135 (C. C. A. 5th), are clearly distinguishable because, although they hold that the use of a method of accounting not legally applicable to the taxpayer may not be an election, they recognize that choice of one of two legal methods applicable to the taxpayer, as in this case, is a binding election.

In the *Key Largo* case the taxpayer reported on the installment basis an income of $64,887.67 from the sale of a tract of Florida land in 1925. The Commissioner refused to accept a computation in an amended return filed in 1927 on the deferred payment basis which disclosed no profit and an uncollected cost of $7,000. The Board held that the basis for the rule of election, the use of a method which correctly reflected income, did not exist because before the close of the year 1925 it was clear that the purchase money second mortgage, included in the contract price in the computation of income on the installment basis, was valueless and the corporate purchaser financially irresponsible. Excluding the second mortgage the Board held that the transaction was in effect the

sale of land, purchased for $36,610 in cash and a first mortgage of $53,250, for the price of $82,860 in cash and an assumption of the mortgage and therefore the installment method did not apply. If the second mortgage is excluded it will be noted, although the Board did not expressly so state, that the installment method was not applicable under the statute because the cash payment of $36,610 was more than 25% of the sale price.

The Board distinguished the *Key Largo* case from *Morrow, Becker & Ewing, Inc.* v. *Commissioner,* 21 B. T. A. 1013, reversed 57 F. (2d) 1 (C. C. A. 5th), and *Morgan Rundel* v. *Commissioner,* 21 B. T. A. 1019, where, as here, the method of reporting income chosen by the taxpayer was within the terms of the statute and did clearly reflect income and, therefore, was a binding election. These three cases decided by the Board on the same day arose out of the collapse of the Florida land boom in 1925.

In the *Morrow* case, *supra,* the facts found by the Board (21 B. T. A. 1013, 1014–1017) disclose that the taxpayer on March 15, 1926, made a return on the installment basis of its profits of $342,869.17 from its sales of real estate in 1925, whether the initial payment was more or less than one-fourth of the sales price. The Commissioner segregated the sales and treated those in which the initial payments did not exceed one-fourth of the sale price as installment sales and the balance as de-

ferred payment sales in which the obligations of the purchasers were treated as equal to the cost of the land to the taxpayer. This increased taxpayer's income by $16,333.77. In December 1926, the taxpayer filed an amended return for 1925, in which it computed the profits by the deferred payment method and showed a loss of $20,874.07.

The Board (21 B. T. A. 1013, 1017) distinguished the *Key Largo* case on the ground that in that case the taxpayer had parted with title for the purchase money second mortgage shown to be valueless within the taxable year, but here, as in the instant case, the taxpayer retained title under the sales contracts and thus on default retained its capital in the form of land and also the cash contract payments. Moreover, the taxpayer made collections of $247,858.96 on the contracts in the following year. The Board held that under the circumstances it could not be said that the taxpayer's income had been distorted to its disadvantage by the installment basis and, therefore, the installment method could not be changed.

The Fifth Circuit Court of Appeals stated that the Board's findings that the contracts had no fair market value and that the value of the land was decreasing in 1925 were inconsistent with its opinion affirming the determination of the Commissioner. The Court also stated that Section 212 (d) of the 1926 Act, adopted shortly before the return was filed, and the regulations under the 1926 Act

adopted shortly thereafter, made substantial changes in the existing law as to the basis for determining profits on installment sales and that therefore the Commissioner abused his discretion in not accepting the amended return.

That case may be distinguished from the present case because it is based upon an alleged abuse of discretion by the Board in failing to accept an amended return in a situation in which, in the court's view, the law was changed at the time the first return was filed. No abuse of discretion by the Commissioner is involved here, because the tax year involved is 1928, and the practice was long settled and the taxpayer did not even attempt to file an amended return, but sought to change from the deferred payment to the installment basis for the first time in his refund claim.

The court did not mention the doctrine of election, and did not deny that election may operate in this type of case. Indeed, in later cases the same court upheld the application of the doctrine of election in cases involving installment sales. *Walker* v. *Commissioner,* 63 F. (2d) 346, 349, *Livermore* v. *Miller,* Prentice-Hall Federal Tax Service, 1938, Vol. 1, paragraph 5.177.

If the court's view that the important question in the case was whether the purchaser's obligations had any fair market value is correct, the present case is also distinguishable because the only evidence on that question in the present case was that

the purchasers' contract obligations have a substantial fair market value (R. 117–118).

Moreover, it is submitted that the decision of the Circuit Court of Appeals in the *Morrow* case is erroneous. The view of the court that substantial changes in reporting installment sales were made after or at about the time the return was filed is not correct. Section 212 (d) of the Revenue Act of 1926 and the regulations adopted pursuant to that Act adopted the installment method authorized by the prior regulations, Regulations 65, Articles 42–46, of the 1924 Act, under which the taxpayer filed its return on the installment basis. The taxpayer must be charged with knowledge of these detailed regulations in force when it filed its return, and the supposed lack of such knowledge suggested by the court supplied no basis for the statement that the Board abused its discretion.

Moreover, this decision in failing to recognize the doctrine of election is inconsistent with the later decisions of the same court in *Walker* v. *Commissioner,* 63 F. (2d) 346, 349, and *Livermore* v. *Miller, supra,* in which the doctrine is enforced.

In *Kaplan* v. *United States,* 18 F. Supp. 965 (C. Cl.) No. 667, this Term, Government's petition for certiorari granted February 14, 1938, and the case set down for argument immediately after this case, the petitioner reported profits from the installment sale of stock in 1929 by the deferred payment method, and after default of payments on the

contract in 1931, sought to change to the installment basis for the first time in a refund claim filed on March 12, 1932. The Court of Claims without citing any of the prior decisions on election discussed above, held that the statute and regulations did not require a binding election.

Insofar as the decision in the *Kaplan* case is based on the court's view that the deferred payment method did not correctly reflect income, the decision is distinguishable because the deferred payment method clearly reflects income in the present case. The Court of Claims in an earlier opinion, *LeBolt & Co.* v. *United States,* 67 C. Cls. 422, 426, recognized this distinction between a case, as here, in which there is a binding choice between two legal and proper methods of returning income, and a case of an erroneous return if there is only legal and proper method of making a return. Cf. *Pathe Exchange* v. *Commissioner,* 77 F. (2d) 306 (C. C. A. 2nd); *Continental Bank & Trust Co.* v. *United States,* 19 F. Supp. 15, 20 (S. D. N. Y.).

Furthermore, the Government contends in its brief in the *Kaplan* case that the decision is wrong because the deferred payment method clearly reflected the income and an election is binding.

In *Ives Dairy Inc.* v. *Commissioner,* 23 B. T. A. 579, affirmed 65 F. (2d) 135 (C. C. A. 5th), the Board followed the *Key Largo* case, *supra,* and permitted a taxpayer to change to the deferred payment basis, although it had reported on the

installment basis a sale of real estate in Florida in 1925 for a price of $60,000 paid in cash and purchased purchase money notes for $177,325, which the Board found had a fair market value of not less than $20,000 during 1925. The Board stated that (p. 584) "Under ordinary circumstances such a change is not permitted," but determined that the case justified application of the rule of the *Key Largo* case where the purchaser's obligations became worthless during the taxable year. The taxpayer petitioned for review and urged that the notes had no fair market value but the Fifth Circuit Court of Appeals affirmed the Board on the ground there was evidence to support the value of $20,000. There is no evidence in the present case to show that the purchaser's obligations were worthless during the taxable year or that in the taxable year a discrepancy so great as in the *Ives* case between face and fair market value could be determined.

Moreover, both the *Key Largo* and *Ives* cases, permitting a change from the installment to the deferred payment method on the ground that the installment method does not clearly reflect income when the purchaser's obligations are determined to be worthless in the taxable year, suggest that where the purchaser's obligations are not worth their face value the deferred payment method more clearly reflects income. Such decisions are no authority for permitting a change from the deferred

payment method to the installment method where, as here, the method originally adopted clearly reflects income.

No extenuating circumstances exist here which would have required the Commissioner to exercise discretion to relieve petitioner from its election even if it had requested such relief. The petitioner's secretary made the return and testified that most of the contracts were sold for 25 per cent. down (R. 108). Even under the 1926 Act and regulations long in force, profit from such contracts could be returned on the installment basis. The taxpayer cannot be excused by a general assertion of lack of knowledge that the installment method was available. Cf. *Moran* v. *Commissioner*, 67 F. (2d) 602 (C. C. A. 1st), *Buttolph* v. *Commissioner*, 29 F. (2d) 695 (C. C. A. 7th).

Moreover, no extenuating circumstances were promptly presented to the Commissioner for administrative relief by an amended return. The excuse comes too late to be heard when it is first presented in testimony on the trial of the refund action.

E. ADMINISTRATION OF THE REVENUES WOULD BE MATERIALLY IMPEDED BY ANY GENERAL RULE ALLOWING TAXPAYERS TO CHANGE FROM ONE METHOD TO ANOTHER IN REPORTING INSTALLMENT SALES

Any general rule of law permitting taxpayers, within the time for filing refund claims, to change the method adopted for reporting income from installment sales for prior years if later events dis-

close that the shift of the taxable gain from one year to another will produce a lower tax, adds an unnecessary complication impeding administration of the revenues.

The underlying basis of the doctrine of election of judicial remedies generally has been stated to be "the maxim which forbids that one shall be twice vexed for one and the same cause." *United States v. Oregon Lumber Co.*, 260 U. S. 290, 301. The important practical consideration of great administrative inconvenience if the choice of method of reporting income from installment sales is not a binding election supplies a substantial and important reason which makes the doctrine of election particularly applicable to the present situation.

The statute and regulations disclose clearly and expressly that a taxpayer may report income from certain installment sales by one of two methods. The application of the doctrine of election is equitable in such circumstances and fairly helps to achieve the desirable policy that tax liability be determined promptly.

II

THE PETITIONER CANNOT NOW HAVE THE INCOME INVOLVED TAXED AS THE INCOME OF A TRUST

The petitioner in point II of its brief (pp. 26–32) raises a new question by the contention that, apart from the question of the use of the installment or deferred payment method, the income from the real estate venture is taxable to it only

to the extent of its distributable share determined by considering the subdivision trust as a strict trust taxable under Section 143–161 of the Revenue Act of 1928.

This new question was not raised or considered in the courts below. The petition for a writ of certiorari did not present it. The brief in opposition does not suggest it. "Review by this Court will be limited accordingly." *Zellerbach Co.* v. *Helvering,* 293 U. S. 172, 182.

The respondent contends that this new point was not presented either in a timely refund claim or in this action in the trial court or the court below and, therefore, there is no jurisdiction to grant a refund on this new ground. Moreover, the new contention is invalid on the merits.

The tax was paid in four installments in 1929 (R. 24). The first and timely refund claim (R. 46–49) filed on February 15, 1931, did not rely on this ground or any related ground. The "amended claim" (R. 50–53) filed on April 4, 1932, after the expiration of the two year period for filing refund claims allowed by Section 322 (b) (1) of the 1928 Act, set forth the additional ground that the trust was an association taxable as a corporation within Section 701 (a) (2) of the 1928 Act. The "amended claim" did not mention the ground now presented.

The amended complaint (R. 4–10) alleged that the trust was an association taxable as a corpora-

tion but did not refer to the new ground now advanced. The trial court made a conclusion of law that the "amended claim" was an amendment not barred by limitations (R. 30) and that the trust was not an association taxable as a corporation (R. 29) but did not refer to the new ground.

The trustee's fiduciary return (R. 149–153), the petitioner's proposed conclusion of law numbered III (R. 175), not adopted by the trial court, and assignments of error numbered 12 and 13 (R. 184–185), might possibly suggest the new ground, although the contention was not more expressly raised or considered by the court below in its opinion.

A. THERE IS NO JURISDICTION TO ALLOW RECOVERY ON THE NEW GROUND, NOT PRESENTED IN A TIMELY REFUND CLAIM OR IN THE PLEADINGS OR TRIAL BELOW

1. This new ground was not presented in either the timely claim or the late "amended claim." A refund claim is a jurisdictional prerequisite to suit and no suit can be maintained in the absence of a refund claim based on the ground asserted in the suit. *United States* v. *Felt & Tarrant Co.*, 283 U. S. 269, 272; *United States* v. *Memphis Cotton Oil Co.*, 288 U. S. 62, 66; T. D. 4265 in effect on May 1, 1929, and adopted pursuant to R. S. Sec. 3226 as amended by Sec. 1113 (a) of the 1926 Act.

2. Even if this new ground had been presented in a late claim before the timely claim was rejected it would have been barred because it is not related

to the first and only timely claim. *United States* v. *Garbutt Oil Co.* No. 262, this Term. *United States* v. *Andrews,* No. 48, this Term, both decided January 4, 1938. The new ground is not presented in the late "amended claim." The new ground and the ground presented in that claim, whether the trust was an association taxable as a corporation, are not related. The "amended claim" did not suggest or require, or in fact procure, an administrative consideration of the new ground. The theories of recovery are different. But even if the new ground were considered to be included in the "amended claim" in some manner that would not aid petitioner because the "amended claim" was not related to the timely claim and was a barred claim. *United States* v. *Garbutt Oil Co., supra, United States* v. *Andrews.*

3. Apart from the lack of a refund claim and even if there had been a timely claim on the new ground there can be no recovery on this ground because it was not pleaded in the complaint. Even an amendment now after expiration of the period of limitations for suits to recover refunds, in order to add this new ground would be unavailing. *United States* v. *Seminole Nation,* 299 U. S. 417; *Lorenzen* v. *United States,* 52 F. (2d) 106 (C. C. A. 8th).

B. APART FROM THE JURISDICTIONAL QUESTION THE INCOME INVOLVED IS TAXABLE TO THE PETITIONER AND NOT TO THE TRUSTEE

Apart from the jurisdictional question which bars any recovery on the new contention, the respondent submits that the contention is without merit because the trust involved is a mere security device and not a trust taxable under Section 161 of the 1928 Act.

The trust here involved was not an active trust conducted by the trustee but was merely the well-known security device known as a "sub-division trust" and commonly used to finance the subdivision and sale of a tract of land in residential lots. Cf. *Lewis & Co.* v. *Commissioner,* 301 U. S. 385. In this case the trustee was merely the agent of the petitioner with the duty of applying part of the profits from the sales of real estate to the payment purchase money notes of the petitioner. In such a situation the gross profits from the sales apply to payment of the petitioner's obligations, are its income and taxable to it. Cf. *Pugh* v. *Commissioner,* 17 B. T. A. 429, 436, affirmed on other issues, 49 F. (2d) 76 (C. C. A. 5th), certiorari denied, 284 U. S. 642; *Cleveland Trust Co.* v. *Commissioner,* 24 B. T. A. 132; *Munger* v. *Commissioner,* 16 B. T. A. 168; *Boynton* v. *Commissioner,* 11 B. T. A. 1352; G. C. M. 2185, VI–2, Cumulative Bulletin p. 75; G. C. M. 4120, VII–2, Cumulative Bulletin p. 108.

Moreover, the record is wholly insufficient to determine the basis upon which the income might be taxed as income of a trust. It is submitted that this new contention is not presented by this case and also that on the merits the income is taxable to the petitioner.

CONCLUSION

The judgment of the court below should be affirmed.

Respectfully submitted.

GOLDEN W. BELL,
Acting Solicitor General.
JAMES W. MORRIS,
Assistant Attorney General.
J. LOUIS MONARCH,
F. E. YOUNGMAN,
Special Assistants to the Attorney General.
EDWARD J. ENNIS,
Attorney.

FEBRUARY 1938.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9:

NET INCOME OF INDIVIDUALS DEFINED

SEC. 212. (d) Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the payment is completed, bears to the total contract price. In the case (1) of a casual sale or other casual disposition of personal property for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed one-fourth of the purchase price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this subdivision. As used in this subdivision the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

INSTALLMENT SALES

SEC. 1208. The provisions of subdivision (d) of section 212 shall be retroactively applied in computing income under the provi-

sions of the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, the Revenue Act of 1921, or the Revenue Act of 1924, or any of such Acts as amended. Any tax that has been paid under such Acts prior to the enactment of this Act, if in excess of the tax imposed by such Acts as retroactively modified by this section, shall, subject to the statutory period of limitations properly applicable thereto, be credited or refunded to the taxpayer as provided in section 284.

Revenue Act of 1928, c. 852, 45 Stat. 791:

PART II—COMPUTATION OF NET INCOME

SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * * *

(e) *Determination of gain or loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in sections 111, 112, and 113.

PART IV—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period.

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits provided for in this title shall be taken for the taxable

year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

SEC. 44. INSTALLMENT BASIS.

(a) *Dealers in personal property.*—Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

(b) *Sales of realty and casual sales of personalty.*—In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 40 per centum of the selling price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

(c) *Change from accrual to installment basis.*—If a taxpayer entitled to the benefits of subsection (a) elects for any taxable year to report his net income on the installment basis, then in computing his income for the year of change or any subsequent year, amounts actually received during any such year on account of sales or other dispositions of property made in any prior year shall not be excluded.

SUPPLEMENT B—COMPUTATION OF NET INCOME

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

* * * * *

(c) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

(e) *Installment sales.*—Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received.

SEC. 112. RECOGNITION OF GAIN OF LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

Treasury Regulations 74:

ART. 321. *Computation of net income.*—Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditures which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See articles 331–333.) If the taxpayer does not regularly employ a method of accounting which clearly reflects

his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

ART. 322. *Bases of computation.*—Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See section 48 for definitions of "paid or accrued" and "paid or incurred." All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as of a different period. * * *

ART. 331. *When included in gross income.*—Gains, profits, and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included as of a different period in accordance with the approved method of accounting followed by him. * * *

ART. 352. *Sale of real property involving deferred payments.* Under section 44 deferred-payment sales of real property fall into two classes when considered with respect to the terms of sale, as follows:

(1) Sales of property on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made do not exceed 40 percent of the selling price.

(2) Deferred-payment sales not on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made exceed 40 percent of the selling price.

Sales falling within class (1) and class (2) alike include (a) agreements of purchase and sale which contemplate that a conveyance is not to be made at the outset, but only after all or a substantial portion of the selling price has been paid, and (b) sales where there is an immediate transfer of title, the vendor being protected by a mortgage or other lien as to deferred payments.

In the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall be included as a part of the "selling price," but the amount of the mortgage, to the extent it does not exceed the basis to the vendor of the property sold, shall not be considered as a part of the "initial payments" or of the "total contract price," as those terms are used in section 44, in articles 351 and 353, and in this article. Commissions and other selling expenses paid or incurred by the vendor are not to be deducted or taken into account in determining the amount of the "initial payments," the "total contract price," or the "selling price."

ART. 353. *Sale of real property on installment plan.*—In transactions included in class (1) in article 352 the vendor may return as income from such transactions in any taxable year that proportion of the installment payments actually received in that year

which the total profit realized or to be realized when the property is paid for bears to the total contract price.

* * * * *

If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursements basis, such a course is permissible, and the sales will be treated as deferred-payment sales not on the installment plan.

ART. 354. *Deferred-payment sale of real property not on installment plan.*—In transactions included in class (2) in article 352, the obligations of the purchaser received by the vendor are to be considered as the equivalent of cash to the amount of their fair market value in ascertaining the profit or loss from the transaction.

If the vendor had retained title to the property and the purchaser defaults in any of his payments, and the vendor repossesses the property by agreement or process of law, the difference between (1) the entire amount of the payments actually received on the contract and retained by the vendor and (2) the sum of the profits previously returned as income in connection therewith and an amount representing proper adjustment for exhaustion, wear and tear, obsolescence, amortization, and depletion of the property while in the hands of the purchaser, will constitute gain or loss, as the case may be, to the vendor for the year in which the property is repossessed, and the basis of the property in the hands of the vendor will be the original basis at the time of the sale. If the vendor had previously transferred title to the purchaser, and the purchaser defaults in any of his payments

and the vendor reacquires the property, such repossession shall be regarded as a transfer by the vendor, in exchange for the property, of such of the purchaser's obligations as are applied by the vendor to the purchase or bid price of the property. Such an exchange will be regarded as having resulted in the realization by the vendor of gain or loss, as the case may be, for the year of repossession, measured by the difference between the fair market value of the property and the basis in the hands of the vendor of the obligations of the purchaser (generally, the fair market value thereof which was previously recognized in computing income) which were applied by the vendor to the purchase or bid price of the property. The fair market value of the property shall be presumed to be the amount for which it is bid in by the vendor in the absence of clear and convincing proof to the contrary. If the property so acquired is subsequently sold, the basis for determining gain or loss is the fair market value of the property at the date of acquisition.

If the obligations received by the vendor have no fair market value, the payments in cash or other property having a fair market value shall be applied against and reduce the basis of the property sold, and, if in excess of such basis, shall be taxable to the extent of the excess. Gain or loss is realized when the obligations are disposed of or satisfied, the amount being the difference between the reduced basis as provided above and the amount realized therefor. Only in rare and extraordinary cases does property have no fair market value.

U. S. GOVERNMENT PRINTING OFFICE: 1938

BLANK

PAGE

p. 3

SUPREME COURT OF THE UNITED STATES.

No. 528.—October Term, 1937.

Pacific National Company, Petitioner,
vs.
Galen H. Welch, Former Collector of Internal Revenue for the Sixth District of California.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[May 2, 1938.]

Mr. Justice Butler delivered the opinion of the Court.

March 14, 1929, petitioner filed its income tax return for 1928. The return reported $137,007.17 as profit resulting from sales of lots in that year. That figure was arrived at by adding to the cash paid in 1928, on account of the sales, the amounts later to be paid, and by deducting from the total the cost of lots and improvements and expenses of the sales.

In 1931 petitioner filed a claim for refund of the entire tax on the ground that the sales had been made on the installment basis, but the profits had been reported as if the sales were for cash, and that this was erroneous. The claim was rejected. Petitioner sued; trial by jury having been waived, the district court made findings of fact and held that petitioner reported income as authorized by the Revenue Act of 1928 and applicable regulations, and thereby made an election which became binding on the expiration of the time allowed for filing the return. Accordingly it gave judgment for respondent. Upon the same ground the circuit court of appeals affirmed. 91 F. (2d) 590. The decision below being in conflict with that of the Court of Claims in *Kaplan* v. *United States*, 18 F. Supp. 965, we granted a writ of certiorari. — U. S. —.

Under the applicable statutes and regulations, petitioner could have chosen either of two methods for the ascertainment and report of gain or loss on the sales. The Revenue Act of 1928, 45 Stat. 791, establishes both. Defining one, the "deferred payment method", it declares that gross income includes profits from sales, § 22(a); regulates the computation of gain or loss, § 22(e); defines gain to be the excess of the amount realized over the basis, §§ 111(a),

113; and provides that the "amount realized" shall be the sum of any money received plus the fair market value of property (other than money) received, § 111(c). Regulations 74, Art. 352. Defining the other, the "installment method", it provides that, in the case of a casual sale or other casual disposition of personal property for a price exceeding $1000 or in the case of sale or other disposition of real property, if payments received during the taxable year in which the sale was made do not exceed 40 per cent of the selling price, the income may, under regulations prescribed, be returned on the installment method (§ 44(b)); i. e., the taxpayer may return in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed bears to total contract price. See § 44(a).

Regulations 74 permit the vendor to return income from installment sales on the straight accrual or cash receipts basis; when so reported the sales are treated as deferred payment sales not on the installment plan. Art. 353. In ascertaining the amount of profit or loss from that class of sales, the obligations of the purchaser to the vendor are taken at their fair market value; if they have none, the payments in cash or other property having a fair market value shall be applied against and reduce the basis of the property sold, and if in excess of such basis, shall be taxable to the extent of the excess. Gain or loss is realized when the obligations are disposed of or satisfied, the amount being the difference between the reduced basis and the amount realized therefor. Art. 354.

The question is whether, having filed a return according to the deferred payment method, the taxpayer by filing claim for refund is entitled to have the profit from the sales computed on the installment method.

Petitioner contends that the installment method alone discloses its income from the sales of lots and that the deferred payment method failed clearly to reflect income.

Conceding that its return might have been made in accordance with either method, petitioner says that, being ignorant of both, it treated the sales as if made for cash at figures mentioned in the contracts. Its argument, therefore, rests upon the assertion, which we assume to be true, that the promises of purchasers to pay installments were worth less than face value. But that fact has no bearing upon the question whether proper application of the deferred payment method would clearly reflect income, for that

method permits installments to be taken at market value and, if they have no market value, allows postponement of ascertainment of gain or loss until realized. While petitioner's return may have been an inept application of the deferred payment method, there is nothing in it or the statement of claim for refund that gives any support to the idea that, if rightly applied, that method would not clearly reflect income.

The parties agree that, if allowed to change to the installment method, petitioner would be entitled to a refund in some amount. But that fact has no tendency to discredit the deferred payment method as inapplicable. The amount of the tax for the year in question is only one of many considerations that may be taken into account by the taxpayer when deciding which method to employ. The one that will produce a higher tax may be preferable because of probable effect on amount of taxes in later years. In case of overstatement and overpayment, the taxpayer may obtain refund calculated according to the method on which the return was made. Change from one method to the other, as petitioner seeks, would require recomputation and readjustment of tax liability for subsequent years and impose burdensome uncertainties upon the administration of the revenue laws. It would operate to enlarge the statutory period for filing returns (§ 53(a)) to include the period allowed for recovering overpayments (§ 322(b)). There is nothing to suggest that Congress intended to permit a taxpayer, after expiration of the time within which return is to be made, to have his tax liability computed and settled according to the other method. By reporting income from the sales in question according to the deferred payment method, petitioner made an election that is binding upon ~~him~~ it and the commissioner.*

Affirmed.

Mr. Justice CARDOZO and Mr. Justice REED took no part in the consideration or decision of this case.

---

* Commissioner *v.* Moore, 48 F. (2d) 526, 528, certiorari denied 284 U. S. 620. Marks *v.* United States, 18 F. Supp. 911, 913. Sylvia S. Strauss, 33 B. T. A. 855, affirmed 87 F. (2d) 1018. Max Viault, 36 B. T. A. 430, 431. Sarah Briarly, 29 B. T. A. 256, 258. Louis Werner Saw Mill Co., 26 B. T. A. 141, 144-145. Liberty Realty Corporation, 26 B. T. A. 1119. Morgan Rundel, 21 B. T. A. 1019. Johnson Realty Trust, 21 B. T. A. 1333. Cf. United States *v.* Pettigrew, 81 F (2d) 666; Rose *v.* Grant, 39 F. (2d) 340; Alameda Inv. Co. *v.* McLaughlin, 33 F. (2d) 120; Buttolph *v.* Commissioner, 29 F. (2d) 695; Safety Electric Products Co. *v.* Helvering, 70 F. (2d) 439; Dr. Pepper Bottling Co. *v.* Commissioner, 69 F. (2d) 768; Radiant Glass Co. *v.* Burnet, 54 F. (2d) 718.